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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
*Petitioner,*

*vs.*

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA,
*Respondents.*

## PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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June 28, 1950

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*Respondents.*

## PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

*To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:*

Your petitioner, UNIVERSAL OIL PRODUCTS COMPANY, prays that a writ of *certiorari* issue to the United States Court of Appeals for the Seventh Circuit to review three final judgments of that Court made and filed April 6, 1950, which judgments, so far as material here, reversed judgments of the District Court in favor of petitioner.

These three cases (Nos. 9902, 9903 and 9904 in the Court of Appeals) were commenced by petitioner in 1947

to recover from the defendant below (the former Collector of Internal Revenue for the First District of Illinois) federal income taxes paid to him by petitioner for the period from November 30, 1944 to December 31, 1946 on the ground that from and after November 29, 1944 petitioner was entitled to exemption therefrom under Section 101(6) of the Internal Revenue Code (26 U. S. C. Sec. 101[6]). The defendant appeared and filed answers taking issue upon the claim of exemption and asserting certain offsets. The United States, by leave of court, intervened to assert against petitioner certain alleged deficiency claims of income and excess profits taxes for the calendar years 1944, 1945 and 1946.

The three cases were tried together in the District Court (R. 956, 958, 960) and were consolidated and argued together in the Court of Appeals (R. 1059).

A certified transcript of the record in the cases, including the proceedings in said Court of Appeals, is furnished herewith in compliance with Rule 38 of this Court.*

## JURISDICTIONAL STATEMENT

Jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1). The final judgments, of which review is sought, were made and filed April 6, 1950.

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*Pursuant to stipulation among counsel for the parties, the original exhibits were not printed in the Court of Appeals but were physically lodged with the clerk of that court. Pursuant to similar stipulation between counsel for the parties, said exhibits, certified by the clerk of the Court of Appeals, have been filed with the Clerk of this Court and for the purpose of this petition have not been printed.

## SUMMARY AND SHORT STATEMENT OF MATTER INVOLVED

Petitioner was incorporated under the General Corporation Law of Delaware on January 27, 1932, and succeeded to the business of a South Dakota corporation of the same name (hereinafter referred to as "South Dakota"), organized in 1914 (R. 528, 652, 682-83; Exh. 120, R. 534; Exh. E, Rider F, R. 355; Exh. 31 accompanying Exh. 90, R. 343; Finding 43, R. 930). Petitioner's charter, like its predecessor's, authorized it, *inter alia*, to engage in research in chemistry, engineering and other scientific fields, in the acquisition, ownership and licensing of patented processes and in the rendering of engineering and other services and the designing of chemical plants (Exh. E, Rider F, R. 355).

Since its organization, petitioner has been, and until that time its predecessor was, engaged in the business of conducting research in the hydrocarbon field, devising refining processes and obtaining patents and licensing the use of processes and patents. Petitioner also sells certain chemicals called catalysts and inhibitors (R. 353, 457-59). It designs apparatus and plants covered by its processes and patents, gives its licensees specified protection against infringement claims, imparts to them its technical "know-how", assists them in breaking in their installations, including the training of their men, furnishes them periodical inspection and other services, renders to them special engineering services at moderate rates, and in general works in close cooperation with them (R. 353, 457-58, 667; Finding 43, R. 930-31).

Between 1931 and 1939 petitioner and its predecessor, South Dakota, adopted a program of expanding their facilities for serving their customers by a series of agreements, many of which also involved the settlement of existing patent litigation (R. 648-53, 664, 678-80).

In some of the agreements petitioner and South Dakota released past infringements of, and gave immunity against suit to, the other contracting parties (Exhs. 41, 42, 44, 46, 47, R. 552-54; R. 649-51) and received releases from past infringements of themselves and their licensees as well as covenants that their licensees would not be sued under the pyrolytic cracking patents of the other parties (*ibid.*). In other agreements, petitioner and its predecessor were granted affirmative licensing rights for both existing and future licenses with respect to all the grantors' patents relating to pyrolytic cracking and, in addition, were paid large sums of money for licenses and releases (Exhs. 40, 43, R. 552-54; R. 651-52, 678-80).

These and other agreements were made indiscriminately with petitioner's shareholders and noteholders and also with companies which were not and never had been security holders (R. 648-63, 692; Exhs. 40-50, 77, 78, NN, OO, PP, R. 552-54, 659, 661, 705).

By such agreements, as the evidence disclosed and as the District Court found, petitioner acquired strength and stability and the ability better to serve its customers (R. 650-56, 660, 661, 664, 667, 678-79, 694-700, 462-3; Findings 44, 45, R. 931). The agreements, it is obvious, were a large, if not the principal, contributing factor to the creation of the value of petitioner, which constituted the *res* of the trust established in 1944, known as The Petroleum Research Fund, which we are about to describe (*ibid.*).

On October 26, 1944, there were outstanding 120,200 shares of petitioner's stock and two series of its income notes of the aggregate principal amount of $8,500,000, with accrued interest, all of which were owned by seven oil companies (Exhs. 143-45, 148, 148A, R. 709, 720; R. 332). There were no other outstanding securities of petitioner of any kind (*ibid.*).

Between October 26, 1944 and November 29, 1944, inclusive, all of the outstanding stock and income notes of petitioner were transferred and delivered by way of gift to Guaranty Trust Company of New York, as Trustee, for scientific and educational purposes, pursuant to the terms of an irrevocable deed of trust dated October 26, 1944, creating "The Petroleum Research Fund" (R. 331-32; Exh. A, R. 331; Finding 20, R. 925-26).

Since November 29, 1944, the Trustee has been the sole owner of all of the outstanding stock and securities of petitioner and holds them for such scientific and educational purposes as to qualify the trust for exemption under Section 101(6) of the Internal Revenue Code (R. 331-36; Findings 21, 23-26, 33, 34, R. 926-29). It is conceded that said trust is exempt from federal taxation (Exh. B to Comp., R. 20; Ans., par. 3, R. 104-105; R. 333; Finding 35, R. 929).

The deed of trust (Exh. A) provides that the qualified recipient of the income shall be an American corporation or foundation (presently American Chemical Society) "organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation" (Exh. A, Art. Third, R. 331; Finding

24, R. 926). American Chemical Society is organized by federal law as a non-profit scientific and educational institution (R. 338, 344-46). Its membership numbers more than 58,000 chemists and it has sections in all parts of the United States (R. 338, 341). The Society has been ruled by the Bureau of Internal Revenue to be entitled to exemption from federal taxation (R. 337-41, 344-49; Exhs. B, C, R. 339; Findings 27, 28, 31, 32, R. 928-29).

On November 16, 1945 petitioner amended its charter to incorporate therein the language of Section 101(6) of the Internal Revenue Code (Exh. E, Rider C, R. 355).

Between the date of the creation of the trust in 1944 and the date of trial, petitioner paid to the Trustee for the purposes of the trust approximately $675,000, and is presently under obligation to pay into the fund a minimum of $200,000 per year (R. 334, 340-41, 347-48; Finding 31, R. 929).

Early in 1946 petitioner filed with the Commissioner and Collector of Internal Revenue the prescribed exemption affidavit, claiming federal income tax exemption from November 30, 1944 under the provisions of Section 101(6) of the Internal Revenue Code. Thereafter, the Commissioner denied exemption on the ground that petitioner was conducting an ordinary business (Exhs. E, F, R. 355; Exh. C to Comp., R. 22; Findings 5-9, R. 924-25).

Petitioner, having paid taxes for 1944, 1945 and 1946, filed claims for refund of the portion thereof paid for the period beginning November 30, 1944 and ending December 31, 1946 and, after the required lapse of time, brought these actions to recover the same on the ground that it was exempt from the payment of income taxes for the period

in question under Section 101(6) of the Internal Revenue Code (26 U. S. C. Sec. 101[6]).

The requirements of Section 101(6), so far as material, are as follows:

(1) that taxpayer be a corporation;

(2) that it be organized exclusively for one of the named exempt purposes;

(3) that it be operated exclusively for one of the named exempt purposes;

(4) that no part of its net earnings shall inure to the benefit of any private shareholder or individual; and

(5) that no substantial part of its activity shall be carrying on propaganda, or otherwise attempting, to influence legislation.

The District Court, on consideration of the evidence, held that petitioner had satisfied the several requirements of Section 101(6) of the Internal Revenue Code (R. 925-31) and concluded that petitioner "is, and since November 29, 1944 has been, exempt from federal income taxes within the meaning of Section 101(6) of the Internal Revenue Code and * * * from federal excess profits taxes" (R. 947).

The defendant and the intervenor in the District Court (the respondents herein) appealed to the Court of Appeals for the Seventh Circuit and, as shown above, that court, by its final judgments made and entered April 6, 1950, reversed the District Court and held that petitioner was not entitled to such income tax exemption on the ground that petitioner was not "organized" or "operated" exclusively

for an exempt purpose (R. 1060-80). The Court of Appeals stated that in view of its conclusion in respect of these two matters it was unnecessary to consider whether or not any part of petitioner's net earnings could inure to the benefit of any private shareholder or individual or whether any substantial part of petitioner's activities related to lobbying (R. 1080).

In view of the failure of the Court of Appeals to consider the last two requirements for exemption, we assume that, at least pending determination by this Court, the following findings of the District Court are unaffected:

> "Since November 29, 1944 no part of the net earnings of plaintiff [petitioner] has been paid to, or has otherwise inured to the benefit of, any private shareholder or individual" (Finding 36, R. 929-30).
>
> "Since November 29, 1944 no substantial part of the activities of plaintiff [petitioner] has consisted of carrying on propaganda, or otherwise attempting, to influence legislation" (Finding 39, R. 930).

## QUESTIONS PRESENTED

1. Is petitioner exempt from federal income taxes under the provisions of Section 101(6) of the Internal Revenue Code?

2. Is petitioner entitled to a liberal construction of the exemption provisions of Section 101(6) of the Internal Revenue Code?

3. May a corporation, which is originally organized as a business corporation to be conducted for profit, subsequently become exempt when all of its stock and other securi-

ties, being the sole means by which its net earnings may be distributed, are irrevocably dedicated to a concededly exempt purpose?

4. Is such a corporation, upon the dedication of its stock and securities to an exempt purpose, organized exclusively for such an exempt purpose?

5. Is such a corporation, when in fact all distributions of its net earnings are made to an exempt trust, operated exclusively for an exempt purpose?

6. Does any part of the net earnings of petitioner inure, as a matter of law, to the benefit of a private shareholder or individual?

7. Were the activities of petitioner, to any substantial extent, the carrying on of propaganda, or otherwise attempting, to influence legislation?

8. Does the failure of petitioner to distribute all of its net earnings prevent it from being exempt?

9. Is the exemption, to which petitioner would otherwise be entitled, defeated by reason of the fact that it paid directors' fees or by reason of the fact that the trustee, under a concededly exempt trust, compensated itself out of the trust income for its services as such trustee?

10. Is not the factual situation, rather than any artificial formality, the criterion for determining compliance with the requirements of Section 101(6) of the Internal Revenue Code?

## REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

Exercise of the discretionary power of this Court to grant the writ of *certiorari* herein prayed for is asked upon the following grounds:

1. The Court of Appeals in the instant cases has rendered a decision in conflict with decisions of the Courts of Appeals for the Second, Fifth and Sixth Circuits, and the decision is believed to be in conflict with the law as laid down by this Court.

2. It would be in the public interest and result in the conservation of the time and labor of the courts for this Court to resolve the conflict.

3. Determination of the questions here presented is important in the proper administration of the revenue laws.

4. In determining that petitioner in the instant cases was not organized exclusively for an exempt purpose, the Court of Appeals has applied a criterion which is untenable and is in conflict with the decisions of other courts of appeals.

5. In determining that petitioner in the instant cases was not operated exclusively for an exempt purpose, the Court of Appeals has applied a criterion which is untenable, is in conflict with the decisions of other courts of appeals and is believed to be in conflict with the applicable decisions of this Court.

WHEREFORE, your petitioner respectfully prays that a writ of *certiorari* be issued out of and under the seal of

this Court, directed to the Court of Appeals for the Seventh Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record of all proceedings in the cases numbered and entitled on its docket Nos. 9902, 9903 and 9904, *Universal Oil Products Company, Plaintiff-Appellee,* v. *Nigel D. Campbell, Defendant-Appellant,* and *The United States of America, Intervenor-Appellant,* and that said judgments of the Court of Appeals for the Seventh Circuit may be reversed by this Court and that your petitioner may have such other and further relief in the premises as to this Court may seem just; and your petitioner will ever pray.

UNIVERSAL OIL PRODUCTS COMPANY,
Petitioner,

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## BRIEF IN SUPPORT OF PETITION FOR A WRIT OF *CERTIORARI*

### THE OPINIONS OF THE COURTS BELOW

The opinion of the Court of Appeals in the instant cases is reported at 181 F. 2d 451. The opinion of the District Court is not reported, but is set forth at page 772 of the record. The District Court's findings of fact and conclusions of law are set forth at pages 923-955 of the record.

### JURISDICTION

The facts supporting the jurisdiction of this Court are set forth in the petition.

Cases believed to sustain the jurisdiction of this Court are as follows:

*Commissioner* v. *Korell*, U. S. , 18 U. S. L. W. 4409 (decided June 5, 1950);
*Reo Motors* v. *Commissioner*, 338 U. S. 442;
*Commissioner* v. *Phipps*, 336 U. S. 410;
*Trinidad* v. *Sagrada Orden*, 263 U. S. 578;
*Magnum Co.* v. *Coty*, 262 U. S. 159.

## STATEMENT OF THE CASE

The facts are sufficiently set forth in the petition.

## SPECIFICATION OF ERRORS

If the writ is granted, petitioner will urge that the Court of Appeals in the instant cases erred in the following respects:

1. In holding that petitioner was not exempt from federal income tax from November 30, 1944 to December 31, 1946, under the provisions of Section 101(6) of the Internal Revenue Code.

2. In holding that petitioner was not entitled to a liberal construction of the exemption provisions of Section 101(6) of the Internal Revenue Code.

3. In holding that petitioner was not organized exclusively for one of the exempt purposes specified in that section.

4. In holding that petitioner was not operated exclusively for one of the exempt purposes specified in that section.

5. In failing to hold that no part of the net earnings of petitioner inured to the benefit of any private shareholder or individual.

6. In failing to hold that no substantial part of the activities of petitioner was carrying on propaganda, or otherwise attempting, to influence legislation.

7. In holding that petitioner, which was originally organized as a business corporation for profit and which originally had private shareholders, might never thereafter be reorganized as an exempt corporation within the meaning of said section.

8. In holding that petitioner, although it was operated during the years under review as a business corporation for the profit of an exempt trust, could not meet the requirements of said section.

9. In holding that petitioner failed to meet the requirements of said section because, in order to acquire patent rights necessary for the successful operation of its business, it had, prior to the period here under review, conferred on various oil companies rights under petitioner's patents.

10. In holding that petitioner was not entitled to the exemption because it failed to distribute all of its net earnings.

11. In holding that petitioner was not entitled to the exemption because it paid directors' fees to its directors.

12. In holding that petitioner was not entitled to the exemption because, it was claimed, the board of directors had power to cause petitioner to issue additional shares of capital stock.

13. In holding that petitioner was not entitled to the exemption because the trustee of the concededly exempt trust, which owned all of petitioner's stock and securities, compensated itself out of the income of the trust for its services.

14. In holding that petitioner was not entitled to the exemption because it devoted a part of its earnings to the improvement of its plant and facilities and to reserves for liabilities.

## ARGUMENT

**THE DECISION OF THE COURT OF APPEALS HEREIN IS IN CONFLICT WITH THE DECISIONS OF THIS COURT AND OTHER COURTS OF APPEALS:**

**A. In holding that petitioner was not entitled to a liberal construction of the exemption provisions of the Internal Revenue Code.**

The Court of Appeals for the Seventh Circuit held that the Government is entitled to a strict construction of the exemption provisions of a tax statute (R. 1066-67). Other Courts of Appeals have held, however, that "Exemptions of income devoted to charity are begotten from motives of public policy and are not to be narrowly construed." *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776, 779; *Commissioner of Internal Reve-*

*nue* v. *Orton*, 6 Cir., 173 F. 2d 483, 486; *Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, 530, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627.

**B. In holding that petitioner from and after November 29, 1944 was not organized exclusively for scientific and educational purposes.**

In the instant cases the Court of Appeals held that petitioner was not "organized" exclusively for any of the exempt purposes. It based this conclusion upon the fact that petitioner was originally organized as a business corporation for profit with private shareholders and conducted the ordinary business activities of a commercial enterprise. It concluded that, petitioner having been so organized, no subsequent change in its status could enable it to be regarded as "organized" exclusively for any exempt purpose (R. 1067-76).

In so holding, the decision of the Court of Appeals is in conflict with the decisions of other courts of appeals. *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776; *Willingham* v. *Home Oil Mill*, 5 Cir., 181 F. 2d 9; *accord, Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627; *Home Oil Mill* v. *Willingham*, N. D. Ala., 86 F. Supp. 568, *aff'd*, 5 Cir., 181 F. 2d 9.

In the leading case of *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue, supra*, taxpayer was incorporated under the New York Stock Corporation Law by one

Roche shortly before his death. Upon its organization, Roche conveyed his public bathing beach property to it in exchange for all of its capital stock. At all times thereafter it was engaged in the same general business activities for profit that Roche had theretofore carried on individually. During the remainder of Roche's life he alone owned the stock and the corporation operated the beach. It was his intention "to continue to operate the property so long as he should live; *and he did so, receiving all the income therefrom until his death*" (p. 777).*

Roche died leaving the stock to trustees for an admittedly exempt purpose. Thereafter, the trustees continued to operate the corporation without making any change in the corporate charter. On these facts, the court of appeals held that the corporation was exempt under Section 101(6), saying (p. 778):

> "As a question of fact, it seems clear that the corporation was organized and operated exclusively for charitable purposes; and the Board made no finding to the contrary. *It denied exemption on the theory that the stated purposes for which a corporation is organized must be found in its charter. We think this is too narrow a view.* Appeal of Unity School of Christianity, 4 B. T. A. 61, is in point. * * * No decision to the contrary has been called to our attention."

While the court accepted the view that Roche's motivation in organizing the corporation under the stock corporation laws was ultimately to use the company as a medium through which the charitable foundation could operate the property and collect the income after his death, it is also

*Italics supplied unless otherwise indicated.

true that Roche's intention was personally "to continue to operate the property so long as he should live" and, indeed, he as sole stockholder received "all the income therefrom until his death" (p. 777). Furthermore, he was at liberty at any time to change his mind as to the gift of the stock in his will. It was not till he died, leaving the stock *irrevocably* for an exempt purpose, that the corporation's status changed from that of an ordinary business tax-paying corporation.

*Home Oil Mill* v. *Willingham,* N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627, *supra,* is to the same effect. One Spight died leaving a gross estate which included all of taxpayer's stock. Taxpayer had been organized as a business corporation and had operated an oil mill and, until Spight's death, there was no evidence of an irrevocable intention to give the corporation's stock to charity. The residuary estate, *including all of the capital stock of taxpayer,* was bequeathed to W. R. Spight Religious and Charitable Trust, which was created by Spight's will for the ultimate benefit of eight admittedly religious, educational, charitable or eleemosynary institutions. The trustees were empowered to operate the business of the corporation and to make distributions to the eight beneficiaries.

In holding that the taxpayer corporation was exempt within the meaning of Section 101(6), the District Court said (p. 530):

> "The evidence discloses that from the date of its reorganization, which was prior to the tax year involved, all of its net earnings have been paid directly to charitable, religious and educational organizations exempt from the tax. Thus, its organization

> and operation, disassociated from provisions of the Spight will, hereinafter discussed, bring it clearly within the principle announced in Trinidad v. Sagrada Orden, etc., supra; Roche's Beach, Inc., v. Commissioner of Internal Revenue, supra; Debs Memorial Radio Fund v. Commissioner of Internal Revenue, 2 Cir., 148 F. 2d 948; Bohemian Gymnastic Ass'n Sokol of City of New York v. Higgins, 2 Cir., 147 F. 2d 774."

In a second case, *Home Oil Mill* v. *Willingham,* N. D. Ala., 86 F. Supp. 568, *supra,* the same judge, in again holding the taxpayer exempt, said of the *Roche's Beach* case (p. 569):

> "* * * it is highly significant that no court of equal authority has disputed it."

On appeal the Court of Appeals for the Fifth Circuit (181 F. 2d 9) affirmed and, in referring to the *Roche's Beach* case, observed (p. 10):

> "It would be difficult to frame legislation against the doctrine in Roche's Beach without at the same time changing the law as announced in Trinidad v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458, and no one seems to want to do that.
>
> * * * * *
>
> "If it is possible for a religious, charitable, and educational trust to operate an industry through a corporate agency, and be exempt under Section 101(6) of Title 26 U. S. C. A., the appellant [Home Oil Mill] is entitled to such exemption."

Both law and reason require that the right of a corporation to be exempted under Section 101(6) of the Internal Revenue Code depend not upon the evanescent

form of its charter, but upon the historical fact of its irrevocable dedication to exempt use. *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Battle Creek,* 5 Cir., 126 F. 2d 405. If it be that the corporation is organized* and operated exclusively for an exempt purpose, that none of its net earnings inures to the benefit of any private individual or shareholder, and that no substantial part of its activities consists of carrying on propaganda, or otherwise attempting, to influence legislation, then, irrespective of the terms of its charter, it is entitled to exemption under the section in question.

Thus the charter in the *Roche's Beach* case was that of an ordinary business corporation without any provisions therein embodying a recitation of any intention of dedication to an exempt purpose.

Similarly, the charter in the *Battle Creek* case was granted under the general corporation laws of Florida. Yet the court held that (p. 406):

> "It is not unusual for charters of corporations to grant broad powers and privileges that are never intended to be used. That does not control the specific purposes of the incorporation."

Moreover, the charter in *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948, was

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*In *Pub. Serv. Comm'n* v. *Rwy. Co.,* 146 Md. 580, 127 Atl. 112, the court, in interpreting Section 20a of the Interstate Commerce Act, which defined a carrier as "any *corporation organized* for the purpose of engaging in transportation by railroad subject to this act", stated (p. 584):

> "Giving the language its natural grammatical effect the word *'organized'* is used in that statute to describe the *present and existing* status of the corporation and not its status or condition *at some past time.*"

framed "as broadly" as that of any business corporation and so remained, although the by-laws were amended to forbid the declaration of dividends. Yet the court, citing the *Roche's Beach* case with approval, held that the corporation was exempt.

In view of the amendment of petitioner's charter in November, 1945 (p. 6, *supra*) to incorporate the exact provisions of Section 101(6) of the Internal Revenue Code, the Court of Appeals should have held petitioner exempt at least from the date of such amendment. In failing to do so, the holding of the Court of Appeals for the Seventh Circuit is in conflict with the holding of the Court of Appeals for the Fifth Circuit in *Willingham* v. *Home Oil Mill, supra.*

**C. In holding that petitioner was not operated exclusively for an exempt purpose.**

In the instant cases the Court of Appeals for the Seventh Circuit based its conclusion, *inter alia,* upon its holding that no company which is engaged in a commercial enterprise for profit can be said to be operated exclusively for an exempt purpose, no matter who its stockholders may be (R. 1076-80).

In so holding, the decision of the Court of Appeals is in conflict with decisions of other courts of appeals and of this Court. *Trinidad* v. *Sagrada Orden,* 263 U. S. 578; *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948; *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins,* 2 Cir., 147 F. 2d 774; *Commissioner of Internal Revenue* v. *Orton,* 6 Cir., 173 F. 2d 483; *Hanover Imp. Soc.* v. *Gagne,* 1 Cir.,

92 F. 2d 888; *Home Oil Mill* v. *Willingham,* N. D. Ala., 86 F. Supp. 568, *aff'd sub nom. Willingham* v. *Home Oil Mill,* 5 Cir., 181 F. 2d 9.

An exempt organization obviously must have funds to further its program. Such an organization, it is recognized, need not be dependent on charitable contributions to carry on its work, but may itself own income-producing properties and engage in income-producing activities. The fact that such activities are competitive in nature and are engaged in solely to produce income does not remove the organization from the exempt category. The courts have uniformly held that it is not the *source* of the income which determines whether an organization is exempt, but its *destination* and the *purpose* for which it is obtained. *Ibid.; Home Oil Mill* v. *Willingham,* N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627.

Thus, in *Trinidad* v. *Sagrada Orden, supra,* plaintiff corporation, organized for religious purposes, received dividends, interest and rent from investments, loans and properties, respectively. The bulk of its income was derived from these sources and the balance from alms, profits from sale of stock and from sale of wine, chocolate and other articles supplied to churches and missions. Plaintiff's claim of exemption was contested on the ground that it was not "operated exclusively" for charitable purposes but that it was operated "also for business and commercial purposes in that it uses its properties to produce income, and trades in wine, chocolate and other articles" (p. 581).

This Court, in holding that plaintiff was exempt, pointed out that the statute recognized that a religious corporation might have a net income and yet remain exempt. The Court also noted that the statute said "nothing about the

source of the income, *but makes the destination* [*of the income*] *the ultimate test of exemption*" (p. 581). The Court, therefore, concluded that "the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain." Such benevolent activities, the Court observed, "cannot be carried on without money" which is generally "received from properties dedicated to their pursuit". Hence, according to this Court, "Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation is created and conducted" (p. 581).

Following the *Trinidad* decision is *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, *supra,* where the plaintiff's sole activity was the operation of an extensive bathing beach for profit, described by the court as follows (p. 777):

> "There were 3,000 bath houses to be let to transient bathers; 34 employees were engaged during the summer; as many as 6,000 persons might patronize the beach on pleasant days; suits and towels were rented; caps, belts and shoes were sold; and restaurant, soda and candy concessions were given out. In 1931 income from the beach property, exclusive of rentals from the other real estate, was more than $85,000, and expenses, omitting taxes, ran to nearly $40,000."

In holding that the corporation was exempt under Section 101(6), despite the nature of its business, since the income therefrom was devoted to exempt purposes, the court stated (p. 778):

"This does not mean that to come within the exemption a corporation may not conduct business activities for profit. The destination of the income is more significant than its source. See Trinidad v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458; Sand Springs Home v. Commissioner, 6 B. T. A. 198, 214; Appeal of Unity School of Christianity, 4 B. T. A. 61."

In *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.*, 2 Cir., 148 F. 2d 948, *supra*, plaintiff's sole activity was the ownership and operation of a radio station. From 1939 to 1942 its revenue from broadcasts was as follows (p. 950):

| "Year | Gross income from broadcasting | Commissions paid | Net Income |
|---|---|---|---|
| 1939..... | $284,294.41 | $52,855.47 | $ 9,221.69 |
| 1940..... | 323,834.16 | 52,955.36 | 30,700.57 |
| 1941..... | 290,385.69 | 55,631.10 | 6,053.68 |
| 1942..... | 294,466.11 | 50,411.44 | 7,449.18" |

In holding that plaintiff was exempt even though its income was principally derived from the selling of radio time in competition with other stations, the court said (pp. 951, 952):

"Nor is it fatal to exemption that substantially all of the petitioner's income is derived from commercial activities since the purpose of making profits has been to enable it to broadcast its educational, civic and cultural programs without charge.

* * * *

" * * * we think the petitioner was 'operated exclusively for the promotion of social welfare.' The purpose of its commercial broadcasts has been to obtain funds to enable it to broadcast its educational, civic and cultural programs without charge. Its

> aim has been only to make station WEVD self-supporting, and up to the end of 1940 the expenses of operation have exceeded receipts by some $37,000."

Similarly, in *Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483, *supra*, the testator bequeathed to a foundation established under his will a going business engaged in the manufacture of pyrometric cones. The purposes of the foundation were described in the will as follows (p. 484):

> "The first and principal purpose is to provide a stable and dependable organization for continuing the manufacture and sale of Standard Pyrometric Cones of the highest quality and most exact accuracy that is commercially feasible, at a reasonable price. The second and subsidiary purpose of this trust is to provide a Research Organization for the prosecution of studies and researches for overcoming technical and manufacturing difficulties, and for thus advancing the ceramic arts and industries in the United States."

In addition to the manufacture of cones "the foundation manufactured and sold the standard mixtures in powdered form to customers who made up their own testing devices". During the years 1934 to 1943, inclusive, the foundation made sales amounting to $637,596.06, from which net profits in the amount of $135,594.59 were realized. The foundation had at least two competitors.*

In holding that the foundation did not lose its exempt status under Section 101(6) because it engaged in com-

*Some of the facts appear from the opinion of the Tax Court, *Edward Orton, Jr. Ceramic Foundation*, 9 T. C. 533, 536, 537, 538.

mercial activity the Court of Appeals, following *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, and *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, said (p. 486):

> "A business does not operate in vacuo—it is related to some objective. With the ordinary business man, it is run for profit and the profits serve his needs. Here the business, which in itself Orton deemed basic for good ceramics, produced profits to be plowed back into the furtherance of research and study in that field. We think that the Commissioner's contention that the taxpayer was engaged in an active, competitive business for profit and that therefore the enterprise could not be considered as exclusively one for scientific or educational purposes is answered by the opinion in Trinidad v. Sagrada Orden de Predicadores, 263 U. S. 578, 44 S. Ct. 204, 205, 68 L. Ed. 458, wherein the statute was construed."

Once petitioner's stock and securities had been irrevocably transferred to a trustee for scientific and educational purposes, petitioner ceased to be an organization whose "net earnings" could in any way benefit a private shareholder or individual. All net earnings thereafter were necessarily dedicated to the public good.

In *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, the court expressly held that a "feeder" corporation, such as petitioner here, could be exempt under Section 101(6), stating (p. 779):

> "No reason is apparent to us why Congress should wish *to deny exemption to a corporation organized and operated exclusively to feed a charitable purpose when it undoubtedly grants it if the corporation*

*itself administers the charity.* We think the language is adequate to describe both types."

*Home Oil Mill* v. *Willingham,* N. D. Ala. (two cases), 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627, and 86 F. Supp. 568, *aff'd,* 5 Cir., 181 F. 2d 9, were also almost identical with the cases before this Court and held to the same effect as in *Roche's Beach.*

Petitioner's agreements (p. 4, *supra*), which the Court of Appeals stressed, obviously do not distinguish the instant cases from those just discussed. The corporations in those cases, like petitioner, necessarily had contractual commitments, entered into in the course of their businesses, and outstanding at the time their net earnings were dedicated to an exempt purpose. Nevertheless they were held to have been operated exclusively for an exempt purpose despite such commitments.

The opinion below ignores reality. Any contract is presumably beneficial to each of its parties. An agreement by a church to purchase an organ, or by a school to retain a professor, presumably benefits the organ maker and the professor. Would anyone contend, however, that the institutions thereby ceased to be operated for an exempt purpose?

So here, even if it be assumed that the agreements benefited those with whom petitioner contracted, they remained peculiarly beneficial to petitioner. Without them, as we have said (p. 4, *supra*), it is obvious that petitioner could not have grown and prospered; with them, the value of petitioner, the *res* of the trust created in 1944, was increased. Under these circumstances, we submit, the Court of Appeals opinion and judgments are clearly in conflict with the prece-

dents. See particularly, *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Orton,* 6 Cir., 173 F. 2d 483; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948; *Hanover Imp. Soc.* v. *Gagne,* 1 Cir., 92 F. 2d 888.

## CONCLUSION

For the foregoing reasons it is submitted that the petition should be allowed and that the aforesaid judgments of the Court of Appeals for the Seventh Circuit in the instant cases should be reviewed and reversed.

Respectfully submitted,

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June 28, 1950

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# In the Supreme Court of the United States

OCTOBER TERM, 1950

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No. 159

UNIVERSAL OIL PRODUCTS COMPANY, PETITIONER

*v.*

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

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## MEMORANDUM FOR THE RESPONDENTS

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### OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (R. 1058-1104) is reported at 181 F. 2d 451.

### JURISDICTION

The judgments of the Court of Appeals were entered on April 6, 1950 (R. 1105-1108). The petition for a writ of certiorari was filed on June

29, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

### QUESTION PRESENTED

Taxpayer-corporation is engaged exclusively in business for profit, its activities consisting primarily of obtaining patents in the petroleum field and licensing its patents to small oil companies on a royalty basis. In 1944, taxpayer's stockholders, several major oil companies, transferred their stock in trust for a tax exempt scientific organization, but taxpayer continued thereafter to carry on its business as before. Under contracts entered into between taxpayer and its former stockholders, the latter are licensed to use taxpayer's patents free of charge, while all other licensees are required to pay royalties to taxpayer.

The question presented is whether, by virtue of the 1944 transfer of its stock, taxpayer became entitled to exemption from federal income tax under Section 101(6) of the Internal Revenue Code as a corporation "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes".

### STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra,* pp. 16-18.

STATEMENT

The material facts as found by the District Court and shown by the evidence [1] may be summarized as follows:

Taxpayer is a Delaware corporation organized in 1932 as successor to the business and substantially all of the assets of another corporation of the same name. Since its organization and throughout the taxable years (1944-1946) it has been engaged exclusively in business for profit. It conducts research in the hydrocarbon field, particularly crude oil, obtains patents on oil refining processes devised by it, and licenses its patents for commercial use. It also furnishes designing and engineering services to its customers, and manufactures and sells certain chemicals called catalysts and inhibitors. Its customers are small and independent oil refiners who do not have adequate experimental and engineering facilities of their own. (R. 923, 930-931; Ex. E, Riders C and F.) During the taxable years, taxpayer owned more than 2,000 patents, had between 600 and 1,000 patent applications pending,

[1] Some of the material and undisputed facts do not appear in the District Court's findings, which were adopted as proposed by taxpayer, but appear in the voluminous documentary exhibits which by stipulation of the parties (R. 1052-1053) were not included in the printed record filed in the court below. These exhibits have been transmitted to the Clerk of this Court, the parties having stipulated that they need not be included in the printed record for purposes of disposition of the petition for certiorari. A summary of the undisputed facts is contained in the opinion below. (R. 1060-1066.)

and was granted 382 United States patents and 142 foreign patents (Exs. 52-54, 134-135, EE, FF). Its operations are carried on in its principal office in Chicago and in a plant near Riverside, Illinois (R. 923, 931-933). Taxpayer's reported gross income for 1944 amounted to $7,167,281, for 1945 it was $6,070,432 and for 1946 it was $4,582,783; the bulk of this income represented royalties received from licensees of its patents (Ex. 93, SS, TT).

On October 26, 1944, all of taxpayer's stock and securities were owned by the following companies: Shell Oil Company, Inc.; Standard Oil Company of California; Standard Oil Company (Indiana); Standard Oil Company (New Jersey); The Texas Company; Phillips Petroleum Company; N. V. de Bataafsche Petroleum Maatschappij. The securities outstanding consisted of 120,000 shares of A stock, 100 shares of C stock, 100 shares of S stock, and $8,500,000 principal amount of C and D income Notes. (Ex. A to complaint, R. 6-7; Ex. E, Riders A, B and C.)

Between October 26 and November 29, 1944, taxpayer's stockholders transferred their stock and notes to the Guaranty Trust Company of New York, as trustee of a "Petroleum Research Fund", for the benefit of the American Chemical Society. Under the trust indenture, the trustee was to pay the net income of the trust (distributions from taxpayer-corporation, less expenses of the trust) to the American Chemical Society, which was to use the

income exclusively for scientific education and research in the petroleum field. Unless directed by court order, the trustee was prohibited from disposing of any of the securities of taxpayer, or from causing taxpayer to discontinue its ownership and licensing of patents. (R. 6-19, 925-926.) Following the transfer of its stock to the Guaranty Trust Company, taxpayer's charter was amended to provide that it was organized and operated exclusively for charitable, scientific, or educational purposes; that no part of its net earnings should inure to the benefit of any private shareholder; but that nothing in the amended charter should be deemed to prevent taxpayer "from continuing to be operated as a stock and business corporation for profit." (Ex. 6 to Rider C of Ex. E). The provisions of the charter authorizing taxpayer to engage in a wide range of business activities for profit were left intact (Ex. E, Rider F, par. "Third").

Under contracts entered into from 1931 to 1939 between taxpayer (or its predecessor) and the oil companies which then owned its stock, the latter acquired the right to use royalty-free all of taxpayer's patents based on inventions made by taxpayer prior to July 1, 1947. The Phillips Petroleum Company acquired such right with respect to patents based on inventions made by taxpayer prior to August 14, 1956. (Exs. 40-80.) Royalties paid to taxpayer by the independent oil companies for the use of taxpayer's patents amounted

to over $4,000,000 for each of the taxable years 1944 and 1945, and over $3,000,000 for the taxable year 1946 (Exs. 93, SS, TT).

Taxpayer's net income for the taxable years as shown by its tax returns amounted to $3,710,727 for 1944, $2,727,326 for 1945, and $901,529 for 1946 (Exs. 93, SS, TT). It distributed nothing to the Guaranty Trust Company during 1944 or 1945. In 1946, it paid to the Guaranty Trust Company interest on its C and D notes in the total amount of $258,963. The Guaranty Trust Company paid itself fees for its services and other expenses out of this amount, and turned over the balance to the American Chemical Society. (Exs. 25-27 of Ex. 90; Ex. E, Rider C.)

The Commissioner of Internal Revenue ruled that both the Guaranty Trust Company, as trustee of the Petroleum Research Fund, and the American Chemical Society, as beneficiary of the trust, were exempt from tax on their income under Section 101(6) of the Internal Revenue Code (R. 20-21, 928-929). The Commissioner refused, however, to grant taxpayer's request for a ruling that it was exempt from tax on its own income (R. 22-23, 924-925). Taxpayer filed income and excess profits tax returns for each of the three taxable years, paid the taxes disclosed by the returns, and filed claims for refund alleging that it was exempt from tax for the period subsequent to the transfer of its stock to the

Guaranty Trust Company. The Commissioner rejected the claims and also notified taxpayer of deficiencies in tax, and suits for refund followed. (R. 923-925.) The District Court, without opinion, held that taxpayer was exempt from federal income and excess profits taxes and directed judgment for taxpayer (R. 945-957). The Court of Appeals reversed on the ground that taxpayer was neither "organized" nor "operated" for the purposes specified in Section 101(6) (R. 1060-1080).

## DISCUSSION

1. To be exempt from federal income tax under Section 101(6) of the Internal Revenue Code (Appendix, *infra*, p. 16), a corporation must, among other things, be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes." On the basis of the undisputed evidence, the court below concluded (R. 1076-1080) that taxpayer was not "operated exclusively" for scientific or educational purposes, but primarily for the benefit of the major oil companies who were its former stockholders. After donating their stock to a tax exempt institution, these companies retained the right to use royalty-free all of taxpayer's patents and inventions. The small independent companies were required to pay substantial royalties to taxpayer, and thus were made to finance the research work the benefits of which the major

companies received *gratis*. As the court below pointed out (R. 1077, 1079, 1080)—

> * * * The donors [major oil companies] thus provided that the plaintiff should continue to carry on the research, development and patent work in the petroleum field, work which was to be financed primarily by the small independent oil companies, work the results of which, for years to come, could be used royalty free by the donors and their subsidiaries. * * *
>
> * * * Here * * * the entire business of plaintiff was for the business betterment of those engaged in the petroleum industry and especially of the major oil companies who were to receive without cost the benefits of all of the plaintiff's discoveries or inventions. * * *
>
> * * * * *
>
> In the instant case the scientific or educational purpose of plaintiff's operation instead of being exclusive was only incidental to the primary purpose of research, development, and securing patents in the petroleum field for the benefit of the petroleum industry and particularly for the major oil companies, in order to improve their business, increase their sales and thereby secure to them greater profits. Resulting benefits to the public were only incidental.

These factual conclusions are not specifically challenged by taxpayer, and they completely dispose of its contention that it is "organized and operated exclusively" for scientific and educational purposes. Unless they are ignored, there is no

occasion here for reaching and deciding the broad question to which the petition for certiorari is addressed, namely, whether a business corporation is to be deemed "organized and operated exclusively" for the purposes specified in Section 101(6) solely by reason of the transfer of its stock to a tax exempt organization. That question is of general importance, and one with respect to which the decisions of the lower courts are inconclusive. Should this Court be disposed to reach and resolve it in this kind of case, the Government would have no objection to the granting of the writ for that purpose. But before undertaking to do so, the Court may wish to await a case which squarely presents the question, such as *C. F. Mueller Co.* v. *Commissioner,* 14 T. C., No. 111 ½, decided May 25, 1950, pending on appeal in the Court of Appeals for the Third Circuit.[2] Since the instant case presents a rather unique factual situation which affords independent ground for denial of the exemption, it is not the most suitable vehicle for resolution of the question.

2. The decision below is correct even if this case were viewed as presenting the bare question of

[2] In the *Mueller* case, all of the stock of a macaroni company was acquired by an educational institution. It seems to raise squarely the issue whether an otherwise non-exempt business corporation achieves an exempt status merely because its stock is acquired by a tax exempt institution and its earnings are to be dedicated ultimately to that institution. It does not appear to involve any extraneous factors, as does the instant case, such as the free use of the taxpayer-corporation's property by its former stockholders.

whether a business corporation becomes tax exempt by virtue of the acquisition of its stock by a tax exempt organization. Section 101(6) exempts from federal income tax a corporation which (1) is "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes"; and (2) "no part of the net earnings of which inures to the benefit of any private shareholder or individual." Compliance with the second condition does not dispense with the necessity for compliance with the first. The corporation, as distinguished from its shareholders, must be organized and operated for the specified statutory purposes. A conventional business corporation engaged solely in profit-seeking business activities does not qualify for tax exemption merely because its earnings inure to the benefit of a tax exempt stockholder. It is not transformed into one "organized and operated exclusively" for charitable and like purposes simply because its stock is transferred to another corporation which is organized and operated for such purposes, nor is it endowed with immunity from tax on its own income simply because its stockholders are immune from tax on their income. The only corporations to which Congress has accorded tax exemption by virtue of the fact that their stockholders are tax exempt are those described in Section 101(14) (Appendix, *infra*, p. 16), namely, corporations "organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the

entire amount thereof, less expenses, to an organization which itself is exempt".[3] Taxpayer admittedly does not fall within that classification. The decision below is in accord not only with the controlling statutory provisions, but with the long-standing implementing Treasury Regulations (Sec. 29.101(6)-1 of Treasury Regulations 111 under the Code, Appendix, *infra*, pp. 17-18), and the applicable decisions of this and other courts. *Better Business Bureau* v. *United States*, 326 U. S. 279; *Trinidad* v. *Sagrada Orden*, 263 U. S. 578, 582; *Bear Gulch Water Co.* v. *Commissioner*, 116 F. 2d 975 (C. A. 9th), certiorari denied, 314 U. S. 652; *Gagne* v. *Hanover Water Works Co.*, 92 F. 2d 659 (C. A. 1st); *Underwriters' Laboratories* v. *Commissioner*, 135 F. 2d 371 (C. A. 7th), certiorari denied, 320 U. S. 756; *Sun-Herald Corp.* v. *Duggan*, 73 F. 2d 298 (C. A. 2d), certiorari denied, 294 U. S. 719; 160 F. 2d 475; *C. F. Mueller Co.* v. *Commissioner*, 14 T. C., No. 111½.[4]

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[3] That Congress did not intend to exempt the net income of a business corporation by reason of the fact that it is distributable to a tax exempt organization is also confirmed by Code Section 23(q)(2), which limits allowable deductions by a corporation on account of contributions to organizations described in Section 101(6) to an amount not exceeding five per cent of its net income.

[4] See also *Allen* v. *Regents*, 304 U.S. 439; *New York* v. *United States*, 326 U.S. 572; *Scholarship Endowment Foundation* v. *Nicholas*, 106 F. 2d 552 (C.A. 10th), certiorari denied, 308 U.S. 623; *Stanford University Book Store* v. *Helvering*, 83 F. 2d 710 (C.A.D.C.); *Davenport Foundation* v. *Commissioner*, 170 F. 2d 70 (C.A. 9th); *Keystone Automobile Club*

To hold that a business corporation is itself exempt from tax because its stockholders are exempt would telescope into one the separate requirements of Section 101(6) that the corporation be organized and operated exclusively for the purposes there specified, and that no part of its net income inure to the benefit of a private shareholder. It would fuse the separate taxable entities of a corporation and its stockholders by ascribing to a corporation whose operations are purely commercial the charitable functions of its stockholders. It would render superfluous Section 101(14), which must be read in conjunction with 101(6). And it would attribute to Congress an intention, nowhere suggested in the statute, to discriminate among competing business enterprises by granting tax immunity to those whose stockholders happen to be tax exempt.

3. Although the decisions of the courts reflect a diversity of approach, the decision below does not appear to be in direct conflict with any decision of this Court or of any of the Courts of Appeals. The court below (R. 1066-1080) painstakingly reviewed the cases upon which taxpayer relies for conflict (Br. 15-28), including *Trinidad* v. *Sagrada Orden, supra,* and *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (C. A. 2d), upon which taxpayer chiefly

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v. *Commissioner,* 181 F. 2d 402 (C.A. 3d); *Chattanooga Automobile Club* v. *Commissioner,* (C.A. 6th), decided June 1, 1950 (1950 C.C.H., par. 9335); *Smyth* v. *California Automobile Assn.,* 175 F. 2d 752 (C.A. 9th).

relies, and pointed out that they each presented material distinguishing features. It considered the instant case as bearing a closer resemblance to, and governed in principle by, those in which the claimed exemption was denied. *Better Business Bureau* v. *United States, supra; Underwriters' Laboratories* v. *Commissioner, supra; Bear Gulch Water Co.* v. *Commissioner, supra; Gagne* v. *Hanover Water Works Co., supra; Sun-Herald Corp.* v. *Duggan, supra.* Nor can it be said that a true conflict is presented by *Willingham* v. *Home Oil Mill,* 181 F. 2d 9 (C. A. 5th), decided after the decision below, and also relied upon by taxpayer. (Br. 19, 22.) That case was not decided on its merits alone, but also on the ground that the Government was estopped from challenging the taxpayer's claim to exemption by reason of a judgment in a prior suit. Insofar as the merits were concerned, the court assimilated the facts there presented to those in the *Roche's Beach* case and accordingly regarded that case as controlling. The court below differentiated the *Roche's Beach* case, and consequently felt no similar compulsion to treat it as dispositive of this case. That taxpayer was operated primarily for the benefit of the major oil companies which formerly owned its stock suffices in and of itself to distinguish this case from those relied upon by taxpayer.

4. Much of the confusion with respect to the basic problem is attributable to a misreading of *Trinidad*

v. *Sagrada Orden,* 263 U. S. 578. In that case, a religious organization that was otherwise tax exempt undertook, as a minor part of its activities, to sell wines and chocolates to its member churches. It was argued that these activities deprived the organization of its tax exempt status because it was not "operated exclusively" for religious purposes. In holding that the organization did not lose its exemption, there was language in this Court's opinion suggesting that the exemption depended not upon the "source of the income", but rather upon its "destination". 263 U. S. at 581. However, the gist of the opinion would appear to be found in the following language (p. 582):

> As respects the transactions in wine, chocolate and other articles, we think they do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in competition with others. The articles are merely bought and supplied for use within the plaintiff's own organization and agencies,—some of them for strictly religious use and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. Financial gain is not the end to which they are directed.

Nevertheless, in view of the prior language that the "destination" rather than the "source" of the income was the test, a widespread practice has

arisen in recent years whereby commercial corporations actively engaged in competitive business have sought exemption, not because their activities were charitable but because of the "destination" of the income, their stock being owned by a charitable institution. We think that the *Sagrada Orden* case was never intended to award tax exempt status to such a business corporation. See the dissenting opinion of Judge Learned Hand, in *Roche's Beach, Inc.* v. *Commissioner, supra.*[5]

Respectfully submitted,

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JULY, 1950.

---

[5] The *Roche's Beach* case was decided in 1938. Although contrary to the general position theretofore taken by the Bureau of Internal Revenue, the decision was at first accepted by the Treasury as a precedent in other cases involving substantially the same facts. Since 1942, however, the Treasury has refused to follow that decision. See G. C. M. 23063, 1942-1 Cum. Bull. 103.

APPENDIX

Internal Revenue Code:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(14) Corporations organized for the exclusive purposes of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

* * * * *

(26 U. S. C. 1946 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.101(6)-1. Religious, Charitable, Scientific, Literary, and Educational Organizations and Community Chests.—In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an associa-

tion of either class has incidental amusement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Code. However, the publication of books or the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting, to influence legislation forms no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial, and educational nature.

Since a corporation to be exempt under section 101(6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt under section 101(6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. See section 101(18) as to religious or apostolic associations or corporations.

A corporation otherwise exempt under section 101(6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1950 894894 18

FILED
SEP 1 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
*Petitioner,*

*vs.*

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA,
*Respondents.*

## REPLY BRIEF OF PETITIONER ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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August 31, 1950.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

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| UNIVERSAL OIL PRODUCTS COMPANY, *Petitioner,* *vs.* NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA, *Respondents.* | No. 159 |

## REPLY BRIEF OF PETITIONER ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The "Memorandum for the Respondents" suggests a short reply.

Respondents concede (M. 9)* that *"the broad question to which the petition for certiorari is addressed,* namely, whether a business corporation is to be deemed 'organized and operated exclusively' for the purposes specified in Section 101(6) solely by reason of the transfer of its stock to a tax exempt organization * * * *is of general importance, and one with respect to which the decisions of the lower courts are inconclusive."***

Respondents also state (M. 9):

> "Should this Court be disposed to reach and resolve it [the above stated question] in this kind of case, the Government would have no objection to the granting of the writ for that purpose."

*Citations to "M. " refer to "Memorandum for the Respondents."

**Italics supplied unless otherwise indicated.

Again Respondents state (M. 12):

> "* * * the decisions of the courts reflect a diversity of approach * * *".

The Government has just filed in this Court a petition for a writ of *certiorari* (Dkt. No. 257, October Term, 1950) to review *Willingham* v. *Home Oil Mill*, 5 Cir., 181 F. 2d 9, upon the decision of which in the Court of Appeals Petitioner relies, *inter alia*, as clearly in conflict with the case at bar.

In its petition in the *Home Oil* case the Government states (p. 2) as the first of "Questions Presented" the following:

> "Whether a business corporation carrying on competitive commercial activities for profit becomes exempt from federal income tax under Section 101(6) of the Internal Revenue Code by reason of the transfer of its stock to an organization which is tax exempt."

In spite of the foregoing, the Government, in its Memorandum addressed to the instant Petition, seeks to distinguish it from other decisions of various courts of appeals in which exemption has been granted to stock corporations (P. B. 15-28).*

The Government's argument in this regard is that the former stockholders of Petitioner are "licensed" to use Petitioner's patents "free of charge" (M. 2, 7-9). This assertion has been answered in our Petition (P. B. 4, 27-28).

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*Citations "P. B. " refer to the "Petition for a Writ of *Certiorari* to the United States Court of Appeals for the Seventh Circuit and Brief in Support Thereof", filed by Petitioner in the instant case.

There we showed that the agreements referred to by Respondents were in general cross-immunity agreements, made many years before the dedication of Petitioner's earnings to a concededly exempt purpose, and were supported on both sides by ample consideration; that such agreements were not confined to security holders, but were entered into indiscriminately with oil companies which were never security holders; that none of the oil companies was granted immunity free of charge; that they all paid for it,—in some instances by return grants of a similar nature and in other instances by grants to Petitioner of affirmative licensing rights and by cash payments aggregating $10,000,000 (R. 651, 678-9). Those transactions were consummated, not for the purpose of benefiting former security holders but, as shown in our Petition and uncontradicted in the record, for the purpose of securing and improving Petitioner's position in the industry.

Respondents suggest that perhaps *C. F. Mueller Co.*, 14 T. C. No. 111½, decided May 25, 1950, a Tax Court case, might be a more appropriate vehicle for decision by this Court (M. 9). That case, however, has not been decided by the Court of Appeals and may never reach this Court. In any event, the *Mueller* case does not differ essentially from the case at bar or other conflicting decisions, such as *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483 and *Willingham* v. *Home Oil Mill*, *supra* (see P. B. 27-28).* In all the foregoing cases, the taxpayers, since they were all in business, necessarily had

*Parenthetically, the Tax Court in the *Mueller* case stated that the Court of Appeals in the case at bar had acted "contrary to the holding of the Court of Appeals for the Second Circuit in the *Roche's Beach* case."

commitments outstanding at the time their earnings were dedicated to an exempt purpose.

It is therefore submitted that a conflict exists between the Second, Fifth, Sixth and Seventh Circuits upon the important question of exemption of a stock corporation under Section 101(6) of the Internal Revenue Code.

Respondents devote a considerable part of their argument (M. 9-12) to a presentation of the merits of the principal controversy, namely, "whether a business corporation becomes tax exempt by virtue of the acquisition of its stock by a tax exempt organization".

We deem it inappropriate upon a petition for a writ of *certiorari* to make an extensive argument upon the merits of that question.

Suffice it to say, however, that the cases relied on by Respondent in this respect are, with the possible exception of the *Mueller* case and *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, on which latter case Petitioner as well as Respondent rely, easily distinguished. *Better Business Bureau* v. *U. S.,* 326 U. S. 279 (M. 11), held that the taxpayer was not exempt from social security taxes since the ultimate object ("destination") of its activities, unlike that of Petitioner, was commercial. In *Bear Gulch Water Co.* v. *Commissioner of Int. Rev.,* 9 Cir., 116 F. 2d 975, *cert. den.* 314 U. S. 652 (M. 11), the issue of exemption under 101(6) does not appear to have been fully litigated. In that case, according to the Government's brief in opposition to petition for writ of *certiorari,* the express finding of the Board of Tax Appeals that taxpayer was neither directly organized for educational purposes nor was its income to be so applied was "undisputed". Furthermore, part of taxpayer's stock in that case was purchased by the exempt organization

merely as an investment and was not, as in the case at bar, dedicated in perpetuity to an exempt purpose, subject only to determination by a court of competent jurisdiction that changed conditions render the continued holding of the stock contrary to the public welfare (Exh. A, Art. Fourth). In the *Bear Gulch* case the stock could have been sold by the exempt organization at any time.

In *Gagne* v. *Hanover Water Works Co.*, 1 Cir., 92 F. 2d 659 (M. 11), it was held that a corporation which derived its income from the sale of water was not organized for the exclusive purpose of holding title to property, collecting the income and turning over the entire amount to an exempt organization, within the meaning of Section 101(14).

In *Underwriters' Laboratories* v. *Com'r of Int. Rev.*, 7 Cir., 135 F. 2d 371, *cert. den.* 320 U. S. 756, the taxpayer was organized by the National Board of Fire Underwriters, composed of fire insurance companies. It conducted research with respect to insurance risks and operated a testing service for manufacturers in return for ample fees. The court held that taxpayer was operated primarily for the benefit of private parties, the insurance companies, and not, as here, for a purely exempt purpose.

*Sun-Herald Corporation* v. *Duggan* (two cases), 2 Cir., 73 F. 2d 298, *cert. den.* 294 U. S. 719, and 160 F. 2d 475 (M. 11), involved claims for exemption under Section 101(14). The only pertinent point in the first case was the remark by the court that the word "organized" when used in subdivision 14 means "incorporated". Thereafter the same court decided the *Roche's Beach* case where, in granting exemption under Section 101(6), the court held that extrinsic evidence as to the purpose of the organiza-

tion was admissible even though the stated purpose made no reference to the charitable character of the corporation. In the second *Sun-Herald* case the court acknowledged that it had modified in the *Roche's Beach* case its pronouncement in the earlier *Sun-Herald* case.

We have not attempted by the foregoing to argue the case *in extenso* upon the merits but we believe that, both in the cases cited in our Petition and those distinguished above, a sufficient indication for present purposes has been given of at least one of the lines of argument upon the merits which we shall make if the writ is issued.

If the Petition is granted, we shall also argue that a comparison of the provisions of the various subdivisions of Section 101 of the Internal Revenue Code demolishes the Government's basic argument and demonstrates that Section 101(6) contemplates the exemption of a stock corporation organized for profit where its net earnings inure only to the benefit of an exempt organization.*

In its petition in the *Home Oil* case, the Government attempts to show that that case is complicated by an issue of collateral estoppel or *res judicata*. Examination of the decision of the Court of Appeals will disclose that, though the court held that the case might be decided on the ground of collateral estoppel, it might equally well rest "solely upon the authority of the majority opinion in Roche's Beach, Inc. v. Commissioner, 2 Cir., 96 F. 2d 777 * * *. Without doubt, the Roche's Beach decision establishes the right of Home Oil Mill to the refund sought." Evincing, however, its recognition of the basic issue in that case, the Government has specified as the first and second errors of the

*We do not here, of course, purport to outline the scope of our entire argument on the merits. That is set forth in "Questions Presented" in our Petition and in "Specification of Errors" in our Brief.

Court of Appeals its failure to decide that a business corporation carrying on competitive commercial operation for profit was not exempt under Section 101(6).

Finally, in its petition in the *Home Oil* case, the Government says of the instant case (p. 6):

> "* * * the Government is not opposing the granting of the writ in that case should this Court be willing to go beyond the facts there involved and undertake to decide the basic question of whether an ordinary business corporation becomes exempt from federal income tax under Sections 101(6) and 101(14) of the Internal Revenue Code * * * merely because its stock is acquired by a tax exempt organization."

The importance of deciding the basic question involved in both this case and in the *Home Oil* case suggests, we respectfully urge, that the Petition be granted and the writ issued. If the Court should deem it advisable to await the *Mueller* case, then we pray, as we understand the Government does in the *Home Oil* case, that the writ be granted here, argument to be deferred, however, until the *Mueller* case is heard.

Respectfully submitted,

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August 31, 1950.

FILED
OCT 30 1950
CHARLES ELMORE CROPLEY

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
*Petitioner,*

*vs.*

NIGEL D. CAMPBELL and the
UNITED STATES OF AMERICA,
*Respondents.*

## PETITION FOR REHEARING

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

| | |
|---|---|
| UNIVERSAL OIL PRODUCTS COMPANY, *Petitioner,* *vs.* NIGEL D. CAMPBELL and the UNITED STATES OF AMERICA, *Respondents.* | No. 159 |

## PETITION FOR REHEARING

*To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:*

Petitioner prays this Court for a rehearing, pursuant to Rule 33, Subdivision 2, of this Court. The argument will be confined to what are believed to be substantial grounds available to petitioner, although not previously presented.*

It is respectfully urged that the petition should be granted for the following reasons:

1. the questions involved in the determination of this case are a matter of public importance by reason of the volume of similar cases pending in the Bureau of Internal Revenue;

*The facts are summarized in our petition for a writ of *certiorari*, pp. 3-8.

2. the failure of Congress for many years to amend in any relevant respect the provisions of Section 101(6) of the Internal Revenue Code indicates, in the face of numerous decisions of lower federal courts interpreting that section favorably to exemption of corporations such as petitioner, an acquiescence in such interpretation; such acquiescence is compatible with petitioner's view as to the correct interpretation of the statute;

3. the enactment of the Revenue Act of 1950 indicates that the questions involved in this case are of importance; and

4. the case at bar is not, to any substantial extent, factually distinguishable from many lower federal court decisions, although the decision of the Seventh Circuit here is in conflict with them; such minor factual differences as may exist should not deprive petitioner of a review, where the same basic legal principles are involved.

## 1.

There are, we are informed, many cases pending in the Bureau of Internal Revenue, involving large sums, in which the principles at stake are the same as in the instant case. The conflict between the instant case and other cases, hereinafter referred to, previously decided by United States Courts of Appeals is such as to create here an adequate vehicle for the settlement by this Court of the questions involved. A determination by this Court of those principles would presumably dispose of the large volume of such tax cases still pending before the Bureau. Under these circumstances there remains, in spite of the radical change of the law by the Revenue Act of 1950 in regard to the issues

here involved, a substantial public interest in an authoritative interpretation of Section 101(6) of the Internal Revenue Code as it existed prior to the enactment of the Revenue Act of 1950.

**2.**

The substance of Section 101(6), in all relevant respects in the form here sued upon, first appeared in 1913 (38 Stat. 172); since that time it has been reenacted, sometimes with amendments,* on ten occasions, not including its incorporation in the Internal Revenue Code in 1939. 39 Stat. 766; 40 Stat. 1076; 42 Stat. 253; 43 Stat. 282; 44 Stat. 40; 45 Stat. 813; 47 Stat. 193; 48 Stat. 700; 49 Stat. 1674; 52 Stat. 481.

On May 28, 1938, subsequent to *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776, the Section was reenacted by Congress without change. 52 Stat. 447, 481. Until the decision of the Court of Appeals for the Seventh Circuit in the instant case, the principle of the *Roche's Beach* case, which we submit is indistinguishable from the instant case (see p. 9, *infra*), was consistently followed.**

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*Never, however, substantially affecting the provisions here relied upon.

***Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.*, 2 Cir., 148 F. 2d 948; *Commissioner of Internal Revenue* v. *Battle Creek*, 5 Cir., 126 F. 2d 405; *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins*, 2 Cir., 147 F. 2d 774; *Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion Jan. 9, 1946, C. C. H. Fed. Tax, 1950 Index 20,627; *Home Oil Mill* v. *Willingham*, N. D. Ala., 86 F. Supp. 568, *aff'd*, 5 Cir., 181 F. 2d 9, *cert. den.*, October 16, 1950. *Bear Gulch Water Co.* v. *Commissioner of Int. Rev.*, 9 Cir., 116 F. 2d 975, *cert. den.*, 314 U. S. 652, is not believed to have been a deviation from the *Roche's Beach* doctrine (see Reply Brief of Petitioner, pp. 4-5).

Meanwhile the Bureau of Internal Revenue, until 1942, accepted the *Roche's Beach* rule. G. C. M. 20853, Cum. Bull. 1938-2, p. 166; G. C. M. 21610, Cum. Bull. 1939-2, p. 103; G. C. M. 22116, Cum. Bull. 1940-2, p. 100; *contra* G. C. M. 23063, Cum. Bull. 1942-1, p. 103.

On March 3, 1942, the Committee on Ways and Means was told by Mr. Randolph Paul, then Tax Advisor to the Secretary of the Treasury, that many corporations engaged in general business activities remained exempt from tax and that such corporations should be taxed on the income derived from businesses not necessarily incident to their exempt activities. As Mr. Paul stated (Vol. 1, Hearings Before Committee on Ways and Means, H. R., 77th Cong., 2d Sess., on Revenue Revision of 1942, p. 89):

> "Our revenue laws have been generous in exempting certain corporations from the income tax. Thus charitable or educational corporations are not subject to the corporate income tax. Many exempt corporations, however, have so far departed from the purpose of the exemption as to engage in trades and business completely unrelated to their exempt activities, and yet the income of such business activities remains exempt from tax. If a college operates a hotel, the earnings of the hotel are exempt; if an orphans' home operates a waterworks and an electric power and gas company, the earnings of these utilities are exempt; if a charitable organization operates a bathing beach, the earnings of the beach are exempt. In this way sources of considerable tax revenue are withdrawn from the scope of the tax. At the same time privately owned businesses are forced to compete with other businesses not subject to an income tax.
>
> "It is believed that the exemptions accorded to such organizations should not be so distorted. It is

> therefore suggested that such corporations be taxed on the income derived from a trade or business not necessarily incident to their exempt activities."*

It is noteworthy that Mr. Paul was obviously referring to *Unity School of Christianity,* 4 B. T. A. 61 (a corporation organized under the Missouri Business Law); *Sand Springs Home,* 6 B. T. A. 198 (a corporation empowered by its charter to engage in the normal activities of a business corporation); and *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776 (involving a corporate taxpayer organized under the New York Stock Corporation Law), respectively. Specifically, in the *Roche's Beach* case, the corporation (taxpayer) had no function except to operate its bathing beach business, and the charity received its net earnings only by virtue of the trustees of the charity owning all of the stock of the corporation,—just as is the case with petitioner herein. Yet the corporation itself was held exempt from federal taxation.

In spite of Mr. Paul's recommendation, Congress took no action at that time with respect to Section 101(6) although it did amend Section 101(16). Revenue Act of 1942, § 137. Thereafter, although the Internal Revenue Code was repeatedly amended in other respects, Section 101(6) remained unchanged until September 23, 1950, when the Revenue Act of 1950 was enacted.

Under these circumstances, we respectfully submit that Congress, prior to 1950, acquiesced in the construction placed upon Section 101(6) in the *Roche's Beach* case and other decisions.

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*The similarity between Mr. Paul's recommendation and the Revenue Act of 1950, as enacted, is apparent.

This Court has consistently held that failure of Congress to change a statute as judicially interpreted, particularly where as here the interpretation is called to its attention and action has been taken upon the statute in other respects, is presumptive evidence that the interpretation is in accord with the intent of Congress. *Francis* v. *Southern Pacific Co.*, 333 U. S. 445; *United States* v. *South Buffalo R. Co.*, 333 U. S. 771; *Walling* v. *Halliburton Co.*, 331 U. S. 17; *Brooks* v. *Dewar*, 313 U. S. 354; *Apex Hosiery Co.* v. *Leader*, 310 U. S. 469; *Electric Battery Co.* v. *Shimadzu*, 307 U. S. 5; *Missouri* v. *Ross*, 299 U. S. 72; *U. S.* v. *Elgin, J. & E. Ry.*, 298 U. S. 492; *United States* v. *Ryan*, 284 U. S. 167; *U. States* v. *R. T. Hooe*, 1 Cranch 318.

The principle involved was enunciated at an early term of this Court, presided over by Chief Justice Marshall, *U. States* v. *R. T. Hooe*, 1 Cranch 318.

It has been followed ever since. (See cases cited above.) Thus, in *Missouri* v. *Ross*, 299 U. S. 72, this Court said (p. 75):

> "These decisions are plainly correct; but if they were doubtful, we should at this late day hesitate to disturb them. *United States* v. *Ryan*, 284 U. S. 167, 174. Moreover, Congress in the face of these decisions has permitted the clause as it now appears in paragraph (6) to stand for many years without change in its phraseology, although amending that portion of the Bankruptcy Act in other particulars. This is persuasive evidence of the adoption by that body of the judicial construction."

The unsuccessful effort of the Treasury Department in 1942 to secure an amendment to Section 101(6) adds weight to the view that the *Roche's Beach* case correctly interpreted the Congressional intent. *United States* v.

*South Buffalo R. Co.*, 333 U. S. 771; *Trade Comm'n* v. *Bunte Bros.*, 312 U. S. 349.

Moreover, the doctrine is not limited to interpretations by this Court. In *Missouri* v. *Ross*, 299 U. S. 72, *supra*, and *Manhattan Prop.* v. *Irving Tr. Co.*, 291 U. S. 320, it was specifically held that the inaction of Congress in the face of lower federal court decisions was persuasive evidence of the adoption by that body of the judicial construction.

The acquiescence of Congress appears all the more probable upon an inspection of Section 101(6). On its face, it seems clear that that Section exempts a stock corporation engaged in business activities where, as here, its net earnings are irrevocably dedicated to exempt purposes. The Section exempts "corporations" no part of the "net earnings" of which inures to the benefit of any "private shareholder" or individual. This patently envisages a stock corporation actively operating for profit, incurring expenses and distributing its "earnings", less expenses, to stockholders who are of the exempted class. Obviously, the corporation may have stockholders for the statute merely requires that no part of its net earnings may inure to the benefit of a *"private* shareholder". Equally obviously, the corporation may be one which *operates* for *profit;* otherwise, it would not have "earnings", as distinguished from rent, interest, or other types of income*, from which would be deducted expenses of operation resulting in "net earnings", no part of which, according to the statute, may inure to the benefit of a

*As Mr. Justice Minton, then Circuit Judge, has said: "The word 'earnings' denotes an 'economic good to which a person becomes entitled for rendering economic *service*'" (italics supplied). *National Labor Relations Bd.* v. *Marshall Field & Co.*, 7 Cir., 129 F. 2d 169, 171. See also *Arey* v. *George Associates, Inc.*, 299 Mass. 130, 135, 12 N. E. 2d 84, 87; *Webster's New International Dictionary* (2d Ed.), "Earnings".

private shareholder. That the corporation may operate for *profit* is further indicated by the circumstance that exempt organizations in other subsections of Section 101 are forbidden to operate for profit, whereas no such restriction is expressed or implied in Subsection (6).* Had Congress not intended that 101(6) corporations be operated for profit, they could have been included in Section 101(7) by the mere addition of the word "corporations" to the list of organizations there set forth.

Section 303 of the Revenue Act of 1950, which provides that no inferences shall be "drawn from the fact that the amendment made by such section [Section 301(b)] is not expressly made applicable with respect to taxable years beginning before January 1, 1951", does not in any way affect inferences which may properly be drawn from the inaction of previous Congresses or from omissions from previous legislation. So it does not preclude or weaken the arguments presented in this petition as to the Congressional intent as it existed *before* the passage of the Revenue Act of 1950.

Under all of the circumstances, it seems to us, Section 101(6) on its face encompasses a corporation engaged in business and operating for profit and a Congressional intent to that effect is demonstrated.

**3.**

In any event, Title III of the Revenue Act of 1950 represents a radical departure, effective as to taxable years beginning after December 31, 1950, from the exemption

*Thus, Subsection (4) applies to cooperative banks "operated * * * without profit". Subsection (7) applies to business leagues and the like "not organized for profit". Subsection (8) applies to civic leagues "not organized for profit". Subsection (9) applies to clubs, organized and operated for "nonprofitable purposes".

provisions of all prior revenue acts enacted since the effective date of the Sixteenth Amendment to the Constitution. It is perfectly clear from a reading of the Revenue Act of 1950 that Congress intended to inaugurate an entirely new approach to the problem of exemptions from federal income taxation. The completeness and thoroughness of the new legislation emphasizes, beyond any necessity for argument, that Congress did not intend a mere clarification of existing law, but clearly intended to *change* the law. This is, in itself, of considerable value in interpreting the Section under which this case was brought and is also cognate to the consideration of whether or not Congress has not heretofore acquiesced in the interpretations given Section 101(6) by federal courts, which we have treated in 2 above.

Moreover, it clearly appears that the question of exemption from federal taxation was of such importance to Congress as to lead that body to legislate extensively concerning it in the Revenue Act of 1950. We respectfully submit that it is of equal importance to the public that the interpretation of Section 101(6) be authoritatively determined by this Court as to the large number of outstanding situations.

**4.**

In the instant case the Court of Appeals (R. 1063, 1076-77) sought to distinguish the instant case from other cases, cited above, of courts of appeals in which exemption was granted.* This was done by holding, contrary to the find-

*In our petition for a writ of *certiorari*, we urged that the Court of Appeals erred in drawing a factual distinction between the case at bar and the other decisions of courts of appeals in conflict herewith. We did not, however, point up that argument by quoting the findings of the District Court and seeking to sustain them affirmatively, as against pointing out the error of the Court of Appeals. That omission is sought to be supplied in this point.

ing of the District Court, that petitioner granted, "royalty free," the right to use its inventions to certain of its former security holders and, therefore, continued to be operated for their benefit.

We urge that there is no evidence to support this holding by the Court of Appeals. The only testimony in the case on the subject was unambiguously to the effect that the transactions referred to were ordinary business transactions between petitioner, on the one hand, and its security holders and others who were not its security holders, on the other hand; that the transactions were at arm's length, supported by ample consideration to petitioner, and highly beneficial to it; and that, far from detracting from petitioner's value or constituting a siphoning off of petitioner's profits, such agreements actually added substantially to the value of the *res* of The Petroleum Research Fund, a concededly exempt organization.

We submit that the following findings of the District Court, which heard the witnesses, are the only findings supported by the evidence (Findings 44, 45, R. 931):

> "In 1931 South Dakota [petitioner's predecessor], and subsequently plaintiff [petitioner], entered into a number of agreements with various oil companies. Some of the parties to some of such agreements were on various occasions prior to November 29, 1944, stockholders or noteholders of plaintiff. Such agreements were entered into, however, with stockholders, noteholders and others indiscriminately. These agreements were the means by which South Dakota and plaintiff built up a patent structure, acquired additional know-how and in general broadened the base of their services. Some of said agreements are set forth in Exhibits 40-50, 76-80, NN, OO and PP. As a result of the agreements, South

Dakota and plaintiff were able to terminate, and avoid the expense of, vexatious litigation, reassure their customers against the harassment of suits and threatened suits and build up a reservoir of processes by which they have been enabled better to serve their customers, which in general have been the smaller so-called independent oil refining companies without research and experimental resources of their own. None of said agreements was intended to have, or did have, the effect of causing plaintiff to be operated for the benefit of any of the other parties thereto or of their successors and none of said agreements had the effect of distributing any of plaintiff's net earnings to, or otherwise causing its net earnings to inure to the benefit of, the other parties to said agreements.

"The said agreements conferred valuable rights on plaintiff, were designed to and did in effect improve the position of South Dakota and plaintiff with respect to serving the public. Part of the value of plaintiff to The Petroleum Research Fund arises from these agreements."

Whatever superficial factual differences may have existed between the instant case and the decisions of other courts of appeals in conflict therewith, they in no wise detract from the availabilty of the instant case as an appropriate vehicle for the interpretation of Section 101(6) with respect to this and numerous other cases which, we are informed, are now pending in the Bureau of Internal Revenue. Certainly such superficial divergence, not affecting the principles involved, should not deprive your petitioner, which is first in time in making its application for a writ of *certiorari*, of the opportunity to have its own case reviewed by this Court.

## CONCLUSION

For all of the foregoing reasons, petitioner respectfully prays that this Court grant a rehearing and issue its writ of *certiorari* for the purpose of determining the questions submitted.

Respectfully submitted,

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## CERTIFICATE OF COUNSEL

The undersigned hereby certifies that the foregoing petition for rehearing is presented in good faith and not for delay and that the petition is restricted to the grounds above specified.

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